MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference. I would like to thank President Knot for his kind hospitality and express our special gratitude to his staff for the excellent organisation of today's meeting of the Governing Council.

High inflation is a major challenge for all of us. The Governing Council will make sure that inflation returns to our two per cent target over the medium term.

In May inflation again rose significantly, mainly because of surging energy and food prices, including due to the impact of the war. But inflation pressures have broadened and intensified, with prices for many goods and services increasing strongly. Eurosystem staff have revised their baseline inflation projections up significantly. These projections indicate that inflation will remain undesirably elevated for some time. However, moderating energy costs, the easing of supply disruptions related to the pandemic and the normalisation of monetary policy are expected to lead to a decline in inflation. The new staff projections foresee annual inflation at 6.8 per cent in 2022, before it is projected to decline to 3.5 per cent in 2023 and 2.1 per cent in 2024 – higher than in the March projections. This means that headline inflation at the end of the projection horizon is projected to be slightly above our target. Inflation excluding energy and food is projected to average 3.3 per cent in 2022, 2.8 per cent in 2023 and 2.3 per cent in 2024 – also above the March projections.

Russia's unjustified aggression towards Ukraine continues to weigh on the economy in Europe and beyond. It is disrupting trade, is leading to shortages of materials and is contributing to high energy and commodity prices. These factors will continue to weigh on confidence and dampen growth, especially in the near term. However, the conditions are in place for the economy to continue to grow on account of the ongoing reopening of the economy, a strong labour market, fiscal support and savings built up during the pandemic. Once current headwinds abate, economic activity is expected to pick up again. This outlook is broadly reflected in the Eurosystem staff projections, which foresee annual real GDP growth at 2.8 per cent in 2022, 2.1 per cent in 2023 and 2.1 per cent in 2024. Compared with the March projections, the outlook has been revised down significantly for 2022 and 2023, while for 2024 it has been revised up.

On the basis of our updated assessment, we decided to take further steps in normalising our monetary policy. Throughout this process, the Governing Council will maintain optionality, data-dependence, gradualism and flexibility in the conduct of monetary policy.

First, we decided to end net asset purchases under our asset purchase programme (APP) as of 1 July 2022. The Governing Council intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates and, in any case, for as long as necessary to maintain ample liquidity conditions and an appropriate monetary policy stance.

Second, we undertook a careful review of the conditions which, according to our forward guidance, should be satisfied before we start raising the key ECB interest rates. As a result of this assessment, the Governing Council concluded that those conditions have been satisfied. Accordingly, and in line with our policy sequencing, we intend to raise the key ECB interest rates by 25 basis points at our July monetary policy meeting.

Looking further ahead, we expect to raise the key ECB interest rates again in September. The calibration of this rate increase will depend on the updated medium-term inflation outlook. If the medium-term inflation outlook persists or deteriorates, a larger increment will be appropriate at our September meeting.

Third, beyond September, based on our current assessment, we anticipate that a gradual but sustained path of further increases in interest rates will be appropriate. In line with our commitment to our two per cent medium-term target, the pace at which we adjust our monetary policy will depend on the incoming data and how we assess inflation to develop in the medium term.

Within the Governing Council's mandate, under stressed conditions, flexibility will remain an element of monetary policy whenever threats to monetary policy transmission jeopardise the attainment of price stability.

The decisions taken today are set out in full in a press release available on our website.

I will now outline in more detail how we see the economy and inflation developing, and will then explain our assessment of financial and monetary conditions.

Economic activity

In the near term, we expect activity to be dampened by high energy costs, the deterioration in the terms of trade, greater uncertainty and the adverse impact of high inflation on disposable income. The war in Ukraine and renewed pandemic restrictions in China have made supply bottlenecks worse again. As a result, firms face higher costs and disruptions in their supply chains, and their outlook for future output has deteriorated.

However, there are also factors supporting economic activity and these are expected to strengthen over the months to come. The reopening of those sectors most affected by the pandemic and a strong labour market, with more people in jobs, will continue to support incomes and consumption. In addition, savings accumulated during the pandemic are a buffer.

Fiscal policy is helping to cushion the impact of the war. Targeted and temporary budgetary measures protect those people bearing the brunt of higher energy prices while limiting the risk of adding to inflationary pressures. The swift implementation of the investment and structural reform plans under the Next Generation EU programme, the "Fit for 55" package and the REPowerEU plan would also help the euro area economy to grow faster in a sustainable manner and become more resilient to global shocks.

Inflation

Inflation rose further to 8.1 per cent in May. Although governments have intervened and have helped slow energy inflation, energy prices stand 39.2 per cent above their levels one year ago. Market-based indicators suggest that global energy prices will stay high in the near term but will then moderate to some extent. Food prices rose 7.5 per cent in May, in part reflecting the importance of Ukraine and Russia among the main global producers of agricultural goods.

Prices have also gone up more strongly because of renewed supply bottlenecks and because of recovering domestic demand, especially in the services sector, as our economy reopens. Price rises are becoming more widespread across sectors. Accordingly, measures of underlying inflation have been rising further.

The labour market continues to improve, with unemployment remaining at its historical low of 6.8 per cent in April. Job vacancies across many sectors show that there is robust demand for labour. Wage growth, including in forward-looking indicators, has started to pick up. Over time, the strengthening of the economy and some catch-up effects should support faster growth in wages. While most measures of longer-term inflation expectations derived from financial markets and from expert surveys stand at around two per cent, initial signs of above-target revisions in those measures warrant close monitoring.

Risk assessment

Risks relating to the pandemic have declined but the war continues to be a significant downside risk to growth. In particular, a major risk would be a further disruption in the energy supply to the euro area, as reflected in the downside scenario included in the staff projections. Furthermore, if the war were to escalate, economic sentiment could worsen, supply-side constraints could increase, and energy and food costs could remain persistently higher than expected.

The risks surrounding inflation are primarily on the upside. The risks to the medium-term inflation outlook include a durable worsening of the production capacity of our economy, persistently high energy and food prices, inflation expectations rising above our target and higher than anticipated wage rises. However, if demand were to weaken over the medium term, it would lower pressures on prices.

Financial and monetary conditions

Market interest rates have increased in response to the changing outlook for inflation and monetary policy. With benchmark interest rates rising, bank funding costs have increased, and this has fed into higher bank lending rates in particular for households. Nevertheless, lending to firms picked up in March. This was because of the continued need to finance investment and working capital, against the backdrop of increasing production costs, persisting supply bottlenecks and lower reliance on market funding. Lending to households also increased, reflecting continued robust demand for mortgages.

In line with our monetary policy strategy, the Governing Council has undertaken its biannual in-depth assessment of the interrelation between monetary policy and financial stability. The environment for financial stability has worsened since our last review in December 2021, especially over the short term. In particular, lower growth and increasing cost pressures, as well as rising risk-free rates and sovereign bond yields, could lead to a further deterioration in the financing conditions faced by borrowers. At the same time, tighter financing conditions could reduce some existing financial stability vulnerabilities over the medium term. Banks, which started the year with solid capital positions and improving asset quality, are now facing greater credit risk. We will watch these factors closely. In any case, macroprudential policy remains the first line of defence in preserving financial stability and addressing medium-term vulnerabilities.

Conclusion

Summing up, Russia’s unjustified aggression towards Ukraine is severely affecting the euro area economy and the outlook is still surrounded by high uncertainty. But the conditions are in place for the economy to continue to grow and to recover further over the medium term.

Inflation is undesirably high and is expected to remain above our target for some time. We will make sure that inflation returns to our two per cent target over the medium term. Accordingly, we decided to take further steps in normalising our monetary policy. The calibration of our policies will remain data-dependent and reflect our evolving assessment of the outlook. We stand ready to adjust all of our instruments within our mandate, incorporating flexibility if warranted, to ensure that inflation stabilises at our two per cent target over the medium term.

We are now ready to take your questions.

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I have two questions. Firstly, one argument that you've made rather frequently over the last few months is that the euro area economy is in a very different place than other advanced economies. Even so, three months after the Fed started raising interest rates, you are now looking to start doing the same. So, is this still about a difference, or are we talking more about a delay at this point?

Second of all: could you tell us a little bit about whether this week's discussion focussed at all on fragmentation risks, and whether there were any new proposals made to address them?

The Governing Council, on the occasion of this meeting organised outside of Frankfurt, in beautiful Amsterdam – thanks to the National Central Bank of the Netherlands – focussed primarily on the challenge of high inflation facing the euro area, and on taking further steps in our normalisation path that we started back in December. So it's not a question of catching up; it's a question of using all the tools that we have in order to deliver on our mandate of price stability and in order to bring inflation down to target over the medium term. Our analysis was obviously that inflation was undesirably high and that we had to take the steps that I have identified in the monetary policy statement.

I would like to add that it's not just a step; it's a journey. We started back in December. We gradually over the course of time put ourselves in a position to move away from unconventional monetary policy, which will actually be taking place as of 1 July, in order to use more conventional tools which are the interest rates. On the issue of the interest rates: we also identified a path, which is not only limited to a particular move, but a series of moves over the course of the next few months depending on the medium-term outlook of inflation.

On the second issue: we have to have the right monetary policy stance; that is critically important and that is what we are doing with that identification of the journey that I just mentioned. But we also have